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In The

Supreme Court of the United States

October Term, 1975

No. 75-420

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION,
Appellants,

v.

THE CHESAPEAKE AND OHIO
RAILWAY COMPANY, ET AL.,
Appellees.

On Appeal From The United States District Court
For The Eastern District of Virginia

BRIEF FOR APPELLEES

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February 6, 1976

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BRIEF FOR APPELLEES

QUESTIONS PRESENTED[1]

Chessie increased its general rate structure by ten percent pursuant to Commission authorization which stated that the preponderance of the revenues derived from the increase *should* be used for deferred maintenance and cap-

[1] Appellees, The Chesapeake and Ohio Railway Company, The Baltimore and Ohio Railroad Company and the Western Maryland Railway Company, are hereinafter collectively referred to as Chessie. Appellant Interstate Commerce Commission is hereinafter referred to as the Commission. References to the Commission's Brief are denoted by CB, references to the Appendix of the Commission's Brief are denoted by App., and references to the Jurisdictional Statement are denoted by JS followed by the appropriate page number. The Interstate Commerce Act, 49 U.S.C. § 1 *et seq.*, is referred to as the Act. All emphasis has been added unless otherwise indicated.

ital improvements. Following the effective date of the rate increase, the Commission issued further orders imposing the condition that such revenues *shall* be used only for "deferred maintenance" and "delayed capital improvements." These terms were defined so as to preclude Chessie's use of the revenues for any purpose (including a $300 million capital improvement program previously scheduled and committed) unless advance approval is obtained from the Commission to use the revenues for new and additional capital improvements "over and above those presently undertaken, scheduled or otherwise committed." Thus Chessie is still denied use of these revenues for its previously scheduled $300 million program.

The questions presented are as follows:

(1) Whether the Commission's statutory power to prescribe rates conferred by Section 15(1) of the Act in conjunction with its suspension power under Section 15(7), can be expanded by implication into the power to impose conditions controlling the disposition of carrier revenues.

(2) Whether such conditions when applied to Chessie violate the Act and the National Transportation Policy, and are arbitrary and capricious.

STATUTES INVOLVED

In addition to the Commission's statutory provisions (CB 3-4), Chessie adds Section 15(1) of the Act:

> "That whenever, after full hearing, upon a complaint made as provided in section 13 of this part, or after full hearing under an order for investigation and hearing made by the Commission on its own initiative, either in extension of any pending complaint or without any complaint whatever, the Commission shall be of opinion that any individual or joint rate, fare, or

> charge whatsoever demanded, charged or collected by any common carrier or carriers subject to this part for the transportation of persons or property as defined in the first section of this part, or that any individual or joint classification, regulation, or practice whatsoever of such carrier or carriers subject to the provisions of this part, is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of this part, the Commission is hereby authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged, and what individual or joint classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent to which the Commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any rate, fare, or charge for such transportation other than the rate, fare, or charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed."

STATEMENT OF THE CASE

This is a direct appeal from the final judgment and orders entered on April 22, 1975 by a district court of three judges specially constituted pursuant to 28 U.S.C. §§ 2284 and 2325 (as then in effect), enjoining the Commission from enforcing against Chessie certain provisions of its orders directing how revenues generated from increased rates should be spent.

On April 22, 1974, the nation's railroads, including Chessie, filed a petition seeking Commission approval to publish tariffs implementing a ten percent increase in their freight rates and charges. This proceeding was docketed as *Ex Parte No. 305*.

In general increase proceedings such as the one initiated on April 22, 1974, the Commission acts under its Section 15(1) powers, and in accordance with the guidelines of Section 15a(2) and the National Transportation Policy. The new tariffs are subject to suspension by the Commission for a maximum period of seven months pending its hearing and decision on the lawfulness thereof. The carriers are free to increase their rates up to the maximum allowed by the Commission. Contrary to the Commission's assertion (CB 6-7), so long as the maximum increase in rates authorized by the Commission is observed, it makes no difference that the resulting *revenues* may be higher than those estimated by the carriers or the Commission. The Commission authorizes a *rate* increase not a *revenue* increase although it must consider the carriers' revenue needs and the amount of revenue that will be generated by the rate increase in arriving at its decision. The Commission "may confine its attention in general revenue proceedings almost entirely to the need for revenue . . . ." *Aberdeen & Rockfish R.R.* v. *SCRAP*, 422 U.S. 289, 314 (1975).

In their April 22nd petition, the railroads described the need for the increase. It was also documented in supporting statements filed by executives of individual railroads and industry association personnel. The industry's petition stated that the carriers had earned a rate of return on net investment in 1973 of only 3.08 percent, ranking the industry next to last among 70 industrial groups. (App. 117.) The petition stated further that approval of the new rates would

increase the industry's rate of return to 5.27 percent, but the industry would remain near last place in terms of the rate of return of all major corporate groups. (App. 118.)

The railroad's petition and the accompanying statements cited a need for additional revenues to strengthen their financial situation and thus enable them to increase their capital outlays and upgrade maintenance.[2] However, the industry resisted suggestions by some shippers that the use of their new revenues be so restricted. The railroads' chief economist, W. F. Betts, in Reply Verified Statement No. 1, advised the Commission in response to such suggestions, that the railroads, despite their poor earnings record, had voluntarily endeavored to improve their property. He testified that the railroads had increased their borrowing to finance needed improvements "at ever higher interest rates" from an aggregate of approximately $10.4 billion at the end of 1966 to $11.6 billion at the end of 1973. During this period, the industry invested over $9.3 billion in their transportation property which is over $400 million more than they generated from net income and depreciation charges and $3.5 billion more than their retained cash flow after dividends. (Railroads' Reply Statement No. 1, Affiant W. F. Betts, pp. 19-21.)

Throughout the *Ex Parte No. 305* proceedings in support of the increase, Chessie made no representations that the additional revenues would be spent in any particular manner or upon any capital improvement or increased maintenance programs. The only filings in the initial stages of *Ex Parte No. 305* by Chessie representatives were income account schedules which indicate that Chessie's operating expenses,

[2] The railroads' representations were many: increased operating costs (App. 102-104), increased cost of borrowed capital (App. 103, 106), severely depressed rate of return on net investment (App. 104), the need to modernize and expand capacity (App. 107), and the general burden of inflation (App. 118).

a figure that includes maintenance of way and equipment, would remain the same *whether or not* the Commission authorized the rate increase. (App. 139-154.)

On June 3, 1974, the Commission entered an order that approved the filing by the railroads of a new tariff embracing a ten percent increase. The order did *not* provide that most of the increase "must be spent on deferred maintenance and delayed capital improvements" as the Commission contends. (CB 10.) Instead, it stated that the carriers "should" spend the additional revenues on "capital improvements" and "deferred maintenance of plant and equipment."[3] In contrast to the precatory language employed in this paragraph, the Commission in other paragraphs of its June 3rd order utilized the mandatory verb "shall" to direct the carriers to file certain reports concerning the extent of deferred maintenance, past and proposed capital spending, estimates concerning the amount of additional revenues to be derived from the rate increase, and the manner in which they were to be employed. (JS 45a-47a.) Commission Vice Chairman O'Neal filed a separate opinion in which he characterized the paragraph of the Commission's June 3rd order dealing with application of the revenues as an "admonition" and called for sanctions to be certain that the desired expenditures were made. (JS 54a.)

By the spring of 1974, Chessie had embarked upon a $300 million capital improvement program which satisfied the Commission's exhortations. Accordingly, along with the rest of the carriers it proceeded to increase its rates effective June 20, 1974.

On July 18, 1974, the Commission entered its second order in *Ex Parte No. 305*. (JS 55a-76a.) This order *for the first*

[3] This is over and above a three percent maximum designed to cover the cost of increased materials and supplies.

time notified Chessie that it must spend its newly-acquired revenues solely upon delayed capital improvements and deferred maintenance as defined in this new order. The term "deferred maintenance" as used in the July 18th order was defined to be "accrued deterioration" in a railroad's plant or equipment, which has rendered its services to shippers "partially or wholly inadequate and/or has resulted in diminishing the railroads' competitive ability." "Delayed capital improvements" were defined to cover only those which were "actually planned" but not undertaken because "funding or financing was not, or projected to be, available through June 30, 1975." (JS 56a.)

Another new condition imposed by the Commission in its July 18th order was that the revenues were required to be segregated in a separate reserve fund unavailable for any purposes other than those just mentioned. (JS 64a-66a.)

Chessie filed a petition for reconsideration, stating that its pending $300 million capital improvement program did not qualify under the Commission's July 18th order. (App. 222-226.) Further, Chessie pointed out that in view of its strong financial position, no project ever scheduled on Chessie could qualify for *Ex Parte No. 305* funds because funding for Chessie, a relatively prosperous system, was always available. Chessie stated that its services were adequate, and that it had no "deferred maintenance" as that term was defined in the order. Accordingly, Chessie requested that it be permitted to use the funds for any "valid corporate purpose," which modification would permit it to use the funds, as it intended, for its capital improvement program. (App. 226.)

By order of August 9, 1974, the Commission denied Chessie's petition. (JS 77a-84a.) The order specifically reserved to management the determination of the extent to

which the defined conditions of deferred maintenance and delayed capital improvements exist in respect of their properties. (JS 81a.) However, the Commission did not change its definitions of "delayed capital improvements" or "deferred maintenance," still defined as projects that had to be deferred because funding was not available or that had diminished the railroads' services and/or competitive stance. Consequently, Chessie still remained ineligible.

Chessie then resorted to its judicial remedies filing suit below on August 15, 1974. (App. 4-14.) On August 18, 1974, Chessie obtained a temporary restraining order against enforcement of the conditions. (App. 30-33.)

On October 3, 1974, in response to a petition on behalf of railroads other than Chessie, the Commission entered an order permitting railroads having neither deferred maintenance nor delayed capital improvements to seek Commission approval to use unexpended *Ex Parte No. 305* funds for "new and additional capital improvements." (JS 104a.) These were defined as projects over and above those *presently* undertaken, scheduled or committed. (JS 102a-103a.)

Chessie amended its Complaint in the district court attacking the October 3rd order, pointing out that its $300 million capital improvement program undertaken before the October 3rd order was still ineligible. (App. 34-44.)

On April 22, 1975, the district court enjoined enforcement of those portions of the Commission's orders that limited the use of the revenues to projects selected and defined by the Commission. After reviewing the pertinent statutory language and the relevant decisions, Circuit Judge Butzner for a unanimous three-judge district court concluded

> ". . . that Congress has not authorized the Commission to control a carrier's expenditure of funds as a condition to withholding the suspension of rates." (JS 22a.)

The Court did not enjoin enforcement of that portion of the Commission's July 18th order which imposed the reporting requirements. The case was remanded to the Commission for further proceedings consistent with the opinion of the district court.

SUMMARY OF ARGUMENT

I.

Introduction

The Commission for the first time in its history assumed direct control over railroad expenditures by requiring the carriers to confine their use of the *Ex Parte No. 305* revenues to projects defined by the Commission as "delayed capital improvements" and "deferred maintenance." It did so by an order entered July 18, 1974—a date subsequent to the effective date of the rate increase.

This is a most serious and far-reaching step, for the authority to decide the purposes and amounts of expenditures covers the whole scope of management. If the Commission has the authority to direct expenditures for maintenance and improvements, it may, in principle, also control the amounts expended for wages, salaries, dividends or any other purpose. If the power asserted by the Commission below is sustained, the Commission will in practical effect have substituted itself for the boards of directors and officers of every railroad in the country. The July 18th order left Chessie no freedom of choice. It was locked in by the Commission's radical departure from an advisory position over carrier expenditures to one of command. However, Chessie, contrary to the Commission's view of the law, did not have to accept illegal conditions as a condition for retaining an otherwise justifiable increase. It was free to challenge the

illegality of the Commission's asserted power to impose conditions, while at the same time retaining the benefits of the order. *United States* v. *Chicago, Milwaukee, St. Paul & Pacific R.R.*, 282 U.S. 311, 328-331 (1931).

II.

The Statute Provides No Power To Impose The Conditions Here At Issue

For this new grant of power the Commission by novel divination cites Section 15a(2) as added by the Transportation Act of 1920 (Act of February 28, 1920, ch. 91, 41 Stat. 456 *et seq.*), and as amended by the Emergency Railroad Transportation Act of 1933 (Act of June 16, 1933, ch. 91, 48 Stat. 217 *et seq.*), as well as the National Transportation Policy (Act of September 18, 1940, 54 Stat. 899). These sections have never before been cited for such a result and indeed the Commission concedes in its brief that no section of the Act provides an "explicit answer" to the question of its asserted power. (CB 37.) Rather it rests its case upon an "implicit authorization" said to be conferred by these sections. (CB 23.)

This is a leap across the boundaries of the statute. Section 15a(2) adds nothing to the Commission's power to set rates; it only mandates consideration of particular factors in the "exercise of its power [conferred by Section 15(1)] to prescribe just and reasonable rates." As the district court found:

> "Never before has the Commission claimed that this section [15a(2)] expands its rate-making power to embrace control over the expenditure of a carrier's revenue." (JS 18a.)

The rate-making power of the Commission (§ 15(1)), which is the substantive provision under which the Commission acted in *Ex Parte No. 305*, is conferred in terms that

reach only the determination of the rate to be charged. There is no hint in the words of the Act or in prior decisions that the power reaches beyond that point to the disposition of the funds received from service pursuant to the tariff. In short, revenues once collected are the property of the carrier, to be used as its management may decide.

The Commission's lack of power to control revenues is made doubly clear by the 1933 repeal of the Recapture Clause and the related carrier in-house reserve fund clause, the only provisions of the Act that in any way dealt with the disposition of carrier revenues. Those provisions commanded in explicit terms that excess revenues be held by the Commission or the carriers in reserve accounts earmarked for special uses. This is the goal of the Commission in *Ex Parte No. 305*, but it lacks any statutory mandate to achieve its purposes.

III.

The Cases Confirm The Commission's Lack Of Power To Control Expenditures

In the light of the statutory scheme that confers upon the Commission the authority to set rates but which reserves to management control over the resulting revenues, it is not surprising that the Commission can cite no decision which supports its usurpation of power. To the contrary, the decisions of this Court "unmistakenly establish that the Commission has no general power to control a railroad's expenditures." (JS 21a.) *United States* v. *Pennsylvania R.R.*, 242 U.S. 208 (1916); *ICC* v. *United States ex rel. Los Angeles*, 280 U.S. 52 (1929). There are also a host of Commission decisions disclaiming any authority over carrier expenditures as well as repeated representations to the same effect by the Commission to the Congress. (Cases cited p. 18, n.5 *infra*.)

IV.

None Of The "Factors" Advanced By The Commission In Support Of The Power Here Asserted Has Any Validity

The Commission seeks to overcome its lack of statutory power to impose the orders in issue, and the contrary judicial and agency decisions by arguing that there are six "factors" said to justify the power here. (CB 23-24.) It concedes that if one or more such factors were absent, the case might stand in a different light. (CB 24.) None of these factors has any validity.

1. Contrary to the Commission's assertion that the conditions are intimately related to its power to set just and reasonable rates because the conditions act to improve the quality of service, the actual effect of the conditions is to prevent Chessie's use of the funds for the improvement of service and thus to militate against the justness and reasonableness of the increased rates.

2. The Commission asserts that the power to prescribe the use of revenues should be sustained because it is here exercised only *indirectly*, and because it has not attempted *directly* to control management decisions. The complete answer is provided by this Court's decision in *T.I.M.E., Inc.* v. *United States*, 359 U.S. 464, 475 (1959), that the Commission may not accomplish indirectly what it lacks authority to do directly.

3. The Commission asserts that the power should be sustained because the orders do no more than direct the carriers to put the increased revenues to a use of the carriers' own choosing. But it certainly was not Chessie's "own choosing" to impound these revenues in a sterile fund which cannot be used for any productive purpose. Moreover, such a requirement is in plain violation of the Commission's mandate under Section 15a(2) and the National Transportation Policy.

4. The Commission contends that the asserted power should be sustained because its orders leave to "management complete discretion concerning how it will expend the revenues within the broadest subject-matter constraints." (CB 24.) But the record contradicts this contention, as applied to Chessie. On the contrary, rather than leaving Chessie's management "complete discretion concerning how it will expend the revenues," the conditions require Chessie to place these funds in a sterile, useless account unavailable for any purpose.

5. The Commission contends that the asserted power should be sustained because the conditions do not require Chessie "to acquire or invest any of its own capital." (CB 24.) Even if one were to assume *arguendo* that the revenues are not Chessie's "own capital" (an extreme proposition), this contention still misses the point altogether. The controlling point is that the conditions deny Chessie the right to invest these revenues, and that for every dollar so denied Chessie has to spend "its own capital" directly out of its treasury for the maintenance and improvement of its plant and facilities.

6. By its final contention that the asserted powers should be sustained because Chessie could avoid the conditions by declining to increase its rates, the Commission is telling Chessie to "take it or leave it." The short answer is that the Commission cannot forego its power to suspend as a trade-off for its imposition of unlawful conditions. Such a boot-strap device could be utilized to support any power asserted by the Commission, however unlawful.

V.

The Conditions Violate The Act And The National Transportation Policy And Are Arbitrary And Capricious

The conditions must not only be annulled because of the Commission's clear lack of power to impose them, but also because as to Chessie they are patently arbitrary, capricious and in direct contravention of the policy guidelines contained in Section 15a(2) and the National Transportation Policy—the very sections upon which the Commission relies to sustain its power.

As Chessie pointed out to the Commission in its petition for reconsideration of the July 18th order (App. 222-226), it had no financing problems and in consequence never deferred worthwhile projects designed to improve its transportation services. Thus, its *Ex Parte No. 305* revenues were unusable under the Commission's orders. Most significantly they could not be applied to a $300 million capital improvement program upon which Chessie had already embarked. The later orders of the Commission did nothing to remedy this impasse.

Indeed, had it not been for the protection of the temporary restraining order and the judgment below, no portion of Chessie's newly-acquired revenues could have been used for maintenance and for such capital improvement program. The conditions penalize Chessie for *not* having deferred maintenance or delayed capital improvements.

Chessie does not quarrel with the Commission over the need for additional improvements if the railroads are to provide adequate and efficient transportation service, the goals of both Section 15a(2) and the National Transportation Policy. In fact, Chessie's submissions, filed with the Commission under the reporting requirements of the July 18th order, establish that during the first three quarters of

1975, Chessie, without legal compulsion, has expended for all types of maintenance and capital improvements almost *nine times* the amount of additional revenues received from the ten percent rate increase. (App. 238-444.)

However, the Commission, while recognizing the need for additional revenues to promote an adequate and efficient railroad system, has acted to deny Chessie the opportunity to use the revenues for any purpose—an arbitrary and capricious result completely contradictory to congressional intent as embodied in Section 15a(2) and the National Transportation Policy.

ARGUMENT

I.

The Commission Has No Statutory Power Express Or Implied To Condition The Manner In Which Railroads May Spend Their Revenues

The Commission's justification for implying the power rests upon three sections of the Act—Section 15a(2) as it first appeared in the Transportation Act of 1920 and as amended in 1933, the National Transportation Policy enacted in 1940 and Section 15(7), the suspension section. Its arguments for implying the power may be refuted simply by a discussion of the background and legislative history of these sections.

In the Transportation Act of 1920, the Commission was granted certain new powers designed to foster an adequate national rail system. First, to end abuses and financial disruptions caused by inter-carrier competition, it was for the first time authorized to fix the exact rate to be charged by the carrier for its transportation services. Prior to this time, the Commission's rate fixing powers had been limited to the prescription of maximum reasonable rates. (Act of

June 29, 1906, Hepburn Act, ch. 3591, § 4, 34 Stat. at 589.) Its powers were now expanded so that:

> ". . . whenever . . . the Commission shall be of opinion that any individual or joint rate . . . is or will be unjust or unreasonable . . . , the Commission is hereby authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate . . . to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged . . . ." (Act of February 28, 1920, ch. 91, § 418, 41 Stat. at 484, codified as 49 U.S.C. § 15(1).)

Second, as another means of combating financial inequality, Congress enacted the Recapture Clause which, together with its companion carrier in-house reserve fund clause, were the *only* provisions in the Transportation Act of 1920 dealing with the involuntary disposition of carrier revenues. The Recapture Clause provided that:

> ". . . any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to, the United States." (*Id.*, § 422, 41 Stat. at 489.)

One half of such excess was to be paid to the Commission. The remainder was to be placed in an in-house reserve fund, up to five percent of total value, and it could be used only for designated purposes.[4]

Section 15a(2) was added by the Transportation Act of 1920. It was not added to expand the powers of the Commission over revenues beyond those granted in the section

[4] In the passage of the Recapture Clause, Congress did the very thing which the Commission attempts to do today under its rate-making function, *i.e.*, create a special fund from the revenues of the carriers earmarked for certain purposes. But Congress did so in clear and explicit language, long since repealed.

just mentioned. Rather, it was added as a concomitant to the new powers granted in the 1920 Act to prescribe rates, *i.e.*, Section 15(1). It merely declares the public policies that shall be taken into account by the Commission in the exercise of its powers to set rates. Thus, the Commission

> ". . . shall give due consideration, among other things, to the transportation needs of the country and the necessity (under honest, efficient and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation . . . ." (*Id.*, § 422, 41 Stat. at 488.)

By 1933 it was realized that the machinery created by the 1920 Act to build up an adequate national rail system was not working and that the carriers in the economic climate then prevailing and for the foreseeable future would not earn excess income nor realize fair rates of return. Congress, therefore, abandoned the fair return on fair value rate-making criterion and repealed the recapture provision and the related in-house reserve fund.

For the new rate-making criterion, Section 15a(2) was amended to provide:

> "In the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management, to provide such service." (Act of June 16, 1933, ch. 91, § 205, 48 Stat. at 220.)

With the 1933 repeal, there came to an end, distinctly and decisively, the only effort by Congress to control the disposition of revenues that had been earned by the carriers. The Commission was left with no authority in that regard.

The Commission concedes that Section 15a(2) *"provides no explicit answer"* to the question of the Commission's powers over the disposition of carrier revenues. (CB 37, n. 27.) But it argues that the 1933 amendments to that section gave the Commission greater flexibility than it had possessed under the 1920 version of the statute and that the new language "substantially expands" its powers. Therefore, the Commission concludes no attention should be paid to this Court's decisions in *ICC* v. *United States ex rel. Los Angeles,* 280 U.S. 52 (1929); *United States* v. *Pennsylvania R.R.*, 242 U.S. 208 (1916), and to the Commission's decisions acknowledging no power over carrier expenditures.

But the Commission's reliance on Section 15a(2), as amended, is entirely misplaced. It still simply mandates consideration of certain factors in the *exercise of the power conferred in Section 15(1) to prescribe just and reasonable rates.* It does not expand the power to prescribe rates into the power to prescribe the uses to which the carriers' revenues are to be applied.

Numerous decisions of the Commission subsequent to the 1933 change in Section 15a(2) have disclaimed any authority over carrier expenditures.[5] Further, there have been repeated representations by the Commission to Congress

[5] *Joseph A. Goddard Realty Co.* v. *New York, Chi., and St. L. R.R.*, 229 I.C.C. 497, 502 (1938); *Jacksonville Pt. Term. Oper. Assn* v. *Alabama, Tenn. & N. R.R.*, 263 I.C.C. 111, 116 (1945); *Oliver Mfg. Supply Co.* v. *Reading Co.*, 297 I.C.C. 654, 658 (1956); *Adequacies-Passenger Service-Southern Pacific Co.*, 335 I.C.C. 415, 420-424 (1969); *Duralite Co., Inc.* v. *Erie Lackawanna Ry.*, 339 I.C.C. 312, 314 (1971); *Increased Freight Rates, 1970 and 1971*, 339 I.C.C. 125, 180 (1971).

since 1933 disavowing any authority to order the purchase or repair of equipment.[6]

The Commission would ignore previous disclaimers of authority over railroad spending by arguing that it may alter its past interpretations in the light of changed conditions citing *American Trucking Associations* v. *Atchison, Topeka & Santa Fe Ry.*, 387 U.S. 397 (1967). (CB 46.)[7] In *American Trucking,* the Commission reversed its earlier view that a trucking company could not utilize railroad trailer-on-flatcar service (TOFC) without the railroads' consent. Instead, it said it could do so under the anti-discrimination provisions of Sections 2 and 3(1) of the Act. In upholding the Commission, this Court noted that the Commission's order was "practically a paraphrase of § 2 of the Act," (387 U.S. at 407), and concluded that regulatory agencies "within the limits of the law" may adapt their rules to meet changing needs in transportation. (387 U.S. at 416.) *American Trucking* would be significant only if the Commission's orders in *Ex Parte No. 305* paraphrased a provision of the Act. But they do not.

It is one thing to say an administrative agency can change its regulatory policies in the light of changes in conditions and shift its emphasis from one section of the Act to another. However, where, as here, there is an abrupt and most sweeping departure from the agency's view of its jurisdiction and

[6] *ICC 86th Annual Report to Congress* (1972) at 23; *ICC 84th Annual Report to Congress* (1970) at 9; *ICC 70th Annual Report to Congress* (1956) at 83; *ICC 61st Annual Report to Congress* (1947) at 128-130; *ICC 56th Annual Report to Congress* (1942) at 15-21 and 123-129.

[7] The Commission in the past has recognized that current economic conditions cannot serve as an excuse for the assumption of novel powers. It has stated that no "jurisdiction is created by changing times or carrier conduct." *Adequacies-Passenger Service-Southern Pacific Co.*, 335 I.C.C. 415, 432 (1969).

powers, a view held throughout its history, and where such departure rests solely on a claimed implication of power, other legal principles come into play. It is well settled that a long-standing administrative construction, accepted over the years without change by Congress, is binding on the agency *New York, New Haven and Hartford R.R.* v. *ICC*, 200 U.S. 361, 401-402 (1906). In consequence, the agency will not be permitted to reverse that construction. *United States* v. *Leslie Salt Co.*, 350 U.S. 383, 396-397 (1956).

This rule is most strikingly applicable here because the Commission is at the same time seeking new legislation, which Congress has so far declined to enact, giving it authority over the disposition of railroad assets. The Commission's orders here attempt to assert such authority. But the Commission plainly recognizes that it has no such power, saying to Congress that it has

> ". . . no powers under the provisions of the Interstate Commerce Act to control or prohibit the use of carrier assets to finance or otherwise facilitate nontransportation investments." *(Letter of Chairman Stafford, dated July 2, 1971, to Senator Vance Hartke, Chairman, Surface Transportation Subcommittee of the Senate Committee on Commerce* at 10.)[8]

Because it has no such power, the Commission has asked Congress to enact bills that would give it such authority. S. 2460, 93rd Cong., 1st Sess. (1973); H.R. 11092, 93rd Cong., 1st Sess. (1973). But the Congress has so far refused to do so. The Commission cannot create such authority by implication. *ICC* v. *Cincinnati, New Orleans and Texas Pacific Ry.*, 167 U.S. 479, 494-495 (1897).

Finally, the Commission says that if Section 15a as originally enacted in 1920 did not cloak the Commission with

[8] *See also ICC 85th Annual Report to Congress* (1971) at 90-91.

authority over carrier spending and if the 1933 amendment of that section did not give it such authority, then that authority was surely conferred by the passage of the National Transportation Policy in 1940. However, the National Transportation Policy, while it may be the yardstick by which the Commission's actions are measured, does not enlarge its substantive powers. *Arrow Transportation Co.* v. *Southern Ry.*, 372 U.S. 658 (1963); *Cotton From Memphis and Helena to New Orleans*, 273 I.C.C. 337 (1948). This interpretation accords with Congressional intent:

> ". . . [the National Transportation Policy] makes no change in the rate-making rule now contained in section 15a of the Interstate Commerce Act, except broadening it to apply to all carriers. Section 15a is now applicable only to rail carriers." (S. Rep. No. 433, 76th Cong., 1st Sess. 5 (1939).)

If the Commission is allowed to interpret the statement of policy as permitting it to do *anything* it deems desirable in the field of transportation, the bounds of power established by Congress will have been destroyed. The National Transportation Policy would then be a source of limitless power. However, that Section 15a(2) and the National Transportation Policy do not authorize conditions governing the use of carrier revenues is clear from a comparison of the general nature of those declarations with the specific tenor of those that fix authority to impose conditions. Such power is found, for example, in Sections 1(20), 5(2)(b) and 20a of the Act. In the face of such explicit authority, any argument that power over revenue is conferred by implication is untenable.

As for the Commission's suspension powers under Section 15(7), we do not understand that it is the Commission's contention that that section standing alone vests power in

the Commission to control railroad spending. Rather, it authorized the Commission to defer the effective date of a *rate* change for seven months pending its determination as to reasonableness. There is no provision express or implied in Section 15(7) that could be interpreted as conferring power on the Commission to control spending.[9]

II.

There Are No Judicial Precedents Supporting The Commission's Arrogation Of Power Over Carrier Spending. All Decisions On The Subject Militate Against The Exercise Of Such Powers.

The Commission's discussion of the judicial precedents said to support its actions will be of no help to this Court. It reviews general language in *Railroad Commission of Wisconsin* v. *Chicago, Burlington & Quincy R.R.*, 257 U.S. 563 (1922); *New England Divisions Case*, 261 U.S. 184 (1923); and *Dayton-Goose Creek Ry.* v. *United States*, 263 U.S. 456 (1924), for the proposition that the Transportation Act of 1920 represents a new departure from old regulatory policies designed to create an adequate railroad system. As *New England* shows, control was found only in the sections of the 1920 Act dealing with recapture of excess income, and the carrier in-house reserve fund. *Dayton-Goose Creek* merely upheld the constitutionality of the Recapture Clause. It demonstrates that it took an Act of Congress (long since repealed) to establish a carrier in-house reserve fund and to specify the sole uses to which the carrier could apply such fund. Here the Commission at-

[9] If the Commission, in fact, is arguing that the suspension power alone can be converted into the power to impose conditions, its position has no support whatever in the legislative history of the section. It does no more than grant the power to suspend while an investigation is made as to the reasonableness of the rate change. (Committee on Interstate and Foreign Commerce, H. Rep. No. 923, 61st Cong., 2d Sess. 3-4 (1910).)

tempts to attain the same goals not by Congressional authorization but by administrative fiat. Finally, the *Wisconsin* case merely involved the Commission's newly-acquired powers to adjust intrastate passenger fare levels.

The only case decided by this Court that the Commission seriously advances as authority for its power is *Florida* v. *United States*, 292 U.S. 1 (1934). This decision was not cited by the Commission below to support its asserted powers. It is easy to understand the omission, for *Florida* does not in any manner stand for the proposition that the Commission may dictate carrier spending. The proceeding arose under Section 13(4) of the Act which granted the Commission power to adjust intrastate freight rates when they were at levels so low as to cast an undue burden on interstate commerce. This Court simply held that repeal of the Recapture Clause did not affect the Commission's Section 13(4) authority. But this Court did not say that the 1933 changes in Section 15a enlarged the Commission's rate-making powers so as to permit the Commission to conrtol carrier spending.

The Commission also relies upon three lower court cases, none of which involves an interpretation of the Act. Primary reliance is placed upon *D. C. Transit System, Inc.* v. *Washington Metropolitan Area Transit Commission*, 466 F.2d 394 (D.C. Cir.), *cert. denied*, 409 U.S. 1086 (1972). That decision is inapposite. It holds that a local regulatory commission may deny a rate increase to a bus company until the company first obtains external equity financing. The *D. C. Transit* case does not constitute authority for the principle that the lawfulness of an increase can be made to depend upon the future satisfaction *vel non* of conditions controlling the use of the newly-generated revenues. No increase was granted and no such conditions were imposed.

The Commission also refers to *United Telephone Co. of Florida* v. *Mayo*, 215 So.2d 609, *appeal dismissed*, 394 U.S. 995 (1968) and *State ex rel Puget Sound Navigation Co.* v. *Department of Transportation*, 33 Wash.2d 448, 206 P.2d 456 (1949). Neither of these cases is apposite. Neither State Commission attempted to control the expenditure of revenues derived from a rate increase. In *United Telephone*, a state agency ordered that service improvements be made before an increase in rates would be approved. In *Puget Sound*, a state agency merely said that if a temporary increase in rates was later found to be unreasonably high, the carrier would refund the difference.

Against the Commission's strained attempt to read into the Act by implication powers that do not exist, may be marshalled this Court's decisions which hold that the Commission cannot be permitted to exercise authority except on the basis of clear and unequivocal statutory commands. *ICC* v. *Cincinnati, New Orleans and Texas Pacific Ry.*, 167 U.S. 479 (1897); *Texas* v. *Eastern Texas R.R.*, 258 U.S. 204 (1922); *T.I.M.E., Inc.*, v. *United States*, 359 U.S. 464 (1959).

Chessie submits that this Court's decisions in *ICC* v. *United States ex rel Los Angeles*, 280 U.S. 52 (1929) and *United States* v. *Pennsylvania R.R.*, 242 U.S. 208 (1916), as well as the decision in *Missouri Pacific R.R.* v. *Norwood*, 42 F.2d 765 (W.D. Ark. 1930), *aff'd* 283 U.S. 249 (1931), establish that the Commission has no general power to control railroad revenue. There has been no clear, unequivocal statutory command.

In the *Los Angeles* case, the Commission claimed it had no power to compel railroads to build passenger stations. In the *Pennsylvania R.R.* case, the Commission denied any authority to order railroads to buy tank cars. This Court sustained the Commission in both instances, saying:

> "A proper statute would seem to require detailed directions, and we should expect the intention to be manifested in plain terms and not to have been left to be implied from the varied regulatory provisions of uncertain scope." (280 U.S. at 69.)
>
> "[I]f Congress had intended such consequence . . . it would not have left its intention to be evolved from obscure language but would have put it in explicit declaration and with notice and time for accommodation to it." (242 U.S. at 231.)

And, as the *Norwood* decision held, the Commission's power to grant or deny rate increases does not imply a power of control over railroad expenditures, 42 F.2d at 773.[10]

We have already referred to the numerous Commission decisions disclaiming power over carrier spending. As noted,

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[10] The Commission argues that in affirming the district court's decision in *Norwood*, this Court held that the term "practice" as used in Section 15a(1) embraces not *only* the setting of rates but the prescribing of service to be rendered by the carriers. The "practices" referred to in Section 15a(1) are the type of practices referred to in Section 15(1) of the Act such as the "individual or joint classification, regulation, or practice [that] is or will be just, fair and reasonable . . . ." This, of course, has nothing whatever to do with control over the expenditure of carrier revenues derived from a general rate increase. In quoting this Court's opinion in *Norwood* (CB 44), the Commission closed the quote much too soon, for the Court goes on to say:

> "The plaintiff further supports its contention by the claim that the Commission is authorized to regulate the expenditures of carriers. That claim is based on the provisions of the act empowering the Commission to regulate rates to be charged . . . and to ascertain rate levels that will yield the fair return provided for. But manifestly there is no similarity between determining what items of expense properly are to be taken into account in calculations made for such purposes and in the prescribing of the number of employees or the compensation to be paid them." 283 U.S. at 257-258.

the Commission's consistent view has been that it lacks such power.

The Commission says that these judicial and agency cases may be discounted for they involved direct control over carrier spending, divorced from rate proceedings. The Commission says it can invoke the power in rate proceedings because "control is exercised indirectly through its power over rates [and it] has not asserted a broad power over management decisions." (CB 48-49.)

The Commission's arguments must fail for two reasons. First, if the Commission lacks direct control over carrier expenditures which is the teaching of the *Pennsylvania R.R.* and *Los Angeles Terminal* decisions, it cannot accomplish the same result indirectly. *T.I.M.E., Inc.* v. *United States,* 359 U.S. 464 (1959).

Second, to label the Commission's action in *Ex Parte No. 305* as only "indirect" control is contrary to the facts. Capital investment is forced into particular categories just as it was attempted to be forced into tank cars and a railroad terminal. There is nothing "indirect" about this prohibition; it is a direct Commission command, a direct assumption of managerial power. The intrusiveness of the claimed power is extreme; its exercise usurps a fundamental management prerogative. In essence, the Commission, in the challenged orders, has commanded that for all railroads, deferred or delayed expenditures must always take priority over new expenditures. Importantly, this command applies without regard to whether "honest, economical and efficient management" would dictate a different result. For example, a railroad having no delayed capital improvements and with its only "deferred maintenance" existing in its fleet of old 50 ton capacity hopper cars would be required under the Commission's orders to repair the old cars with its *Ex Parte No. 305* revenues even though an honest, efficient and economical management decision would dictate the purchase of *new* and more efficient 100 ton capacity cars instead.

For the industry in general, the Commission has restricted the use of a substantial body of funds to narrowly-defined projects. The numerous petitions for relief from these restrictions attest to the difficulties the carriers are having with the orders. (App. 452-502.) The management of the Milwaukee Railroad was permitted to use the *Ex Parte No. 305* funds for general operating expenses only if it treated the transfer of these funds out of the reserve account as a "borrowing" to be repaid later. (App. 477-479.) The management of seven other railroads had to petition the Commission to obtain permission to use *Ex Parte No. 305* revenues to (1) purchase new or used locomotives and cars; (2) repair existing equipment; (3) construct new facilities; and (4) make roadway improvements. (App. 457.) The management of the Richmond, Fredericksburg and Potomac Railroad Company had to obtain Commission permission before using new revenues to purchase fifty gondola cars. (App. 482.) The management of the Sandersville Railroad had to obtain permission to use *Ex Parte No. 305* revenues to help build a new maintenance building and upgrade four miles of track. (App. 475.) The management of the Cuyahoga Valley Railway Company had to obtain Commission permission to use new revenues to buy 20 gondola cars. (App. 497.) Six petitions have been denied. There is no escape from the conclusion that such necessity for Commission approval of expenditures is altogether inconsistent with the statutory scheme.

For Chessie, in particular, the orders would have prevented any use of the funds for any maintenance whatever and for its $300 million capital improvement program had it not been for the action of the district court. These revenues

would have remained in a sterile, useless account unavailable to management.

The far-reaching effect of the Commission's orders cannot be stressed too strongly. Today the Commission has restricted spending to deferred maintenance and delayed capital improvements, narrowly defined. Tomorrow, under the same authority it now asserts, it could designate with particularity the nature of the equipment and facilities on which the funds must be spent—actions contrary to the precedents of the *Los Angeles Terminal* and *Pennsylvania R.R.* decisions.

Nor is it implausible that the Commission could intrude into the area of dividend payments and carrier investment by specifying the amount of carrier revenues that may be used for these purposes. Conceivably, it could dictate the amount and timing of wage increases by requiring segregation of revenues for such purposes.

If such vast and comprehensive powers are to be bestowed on the Commission, it must be through a clear and explicit Congressional mandate and not by agency decree.

III.

The Conditions, By Preventing The Use Of The Revenues For The Purposes Contemplated By The Statute, Are In Direct Contravention Of The Congressional Mandate Under Section 15a(2) and The National Transportation Policy.

The precarious capital posture of the railroad industry is known to all. The Commission makes an extended excursion through the record (CB *passim*) to establish that the nation's railroads require vast infusions of new capital if they are to place themselves in a position to meet the demands placed upon them by an expanding economy. Chessie has no quarrel with this statement of the obvious. But such

capital investment must be in accordance with the statutory scheme which reserves to management the decision as to the purposes to which its revenues will be applied.

The Commission has attempted to overthrow the statutory scheme. The problems created thereby are best illustrated by the fact that its orders bar Chessie from using the *Ex Parte No. 305* revenues for its $300 million capital improvement program. Such a bar is not only unauthorized by the Act but is in direct contravention of Section 15a(2) and the National Transportation Policy, the very provisions upon which the Commission relies.

Under Section 15a(2) and the National Transportation Policy, carrier need is a mandatory consideration for passing on rate change proposals. But the Commission, after finding that the statutory need exists, contravenes these guidelines and ignores its own order by appending conditions which prevent Chessie from using its revenues for the very purposes contemplated by the Act, namely the operation of an adequate and efficient transportation system. Thus, the requirements imposed by the conditions upon Chessie, had it not been for the district court's protection, would have militated against the Commission's justification for the increase. In any event, the justness and reasonableness of the increase cannot be made to depend upon conditions which the Commission has no lawful authority to impose.

IV.

The Commission's Orders Are Arbitrary And Capricious And, Therefore, Are Unlawful Under The Administrative Procedure Act.

Although it devotes a major portion of its brief to a defense of the wisdom of the challenged orders, the Commission states that the sole issue before this Court is the

power of the Commission to make the orders rather than their reasonableness.

> "That is the only issue presented in this case, and it does not depend upon whether the restrictions on the use of the revenues are reasonable, supported by evidence, or otherwise in accord with the standards governing the Commission's exercise of its discretion." (CB 26.)

But Chessie, as appellee, is not confined solely to the issue of power advanced by the Commission. In the district court, Chessie raised issues as to the arbitrary, capricious and unlawful nature of the Commission's orders as applied to Chessie. They are summarized below and compel the conclusion that the Commission's orders violated the requirements of the Administrative Procedure Act. (5 U.S.C. § 706 (1970).)

First. The orders are arbitrary and capricious because they bar the use of the funds for Chessie's capital improvement program. In Chessie's case, such sterilization of the funds demonstrates conclusively that the conditions do absolutely nothing to support the justness and reasonableness of the rates.

Second. As a consequence, except for the relief accorded below, Chessie's shippers would have paid increased rates with no offsetting benefits. (App. 19-21, 225.)

Third. The Commission contends that "[t]he railroads' incentives to scrimp on maintenance would of course survive any revenue increase no matter how large," (CB 22), and that these practices justified the conditions. Chessie's capital spending and maintenance programs belie this claim. As revealed in its quarterly reports to the Commission (App. 238-444), in the first nine months of 1974, Chessie spent over $238 million for capital improvements and maintenance. In the first nine months of 1975, its expenditures for these purposes totaled over $402 million—an increase of

roundly $164 million. In contrast, the rate increase generated only $18.6 million in additional revenues in the first nine months of 1975 after deductions for additional income taxes and increases in the cost of materials and supplies. Thus, without administrative compulsion, Chessie spent almost *nine times* its available *Ex Parte No. 305* revenues in additional improvements and maintenance.

The Commission has no genuine response to these facts. Instead, it makes a *post hoc* attempt to establish that Chessie's new revenues could be utilized under its orders. This contention is nothing more than an attack upon its own record. Subsequent to the July 18th order, Chessie, in its petition for reconsideration, stated that it had no projects within the scope of the Commission's definitions. Such statements in the petition constitute evidence under the Commission's Rules. 49 C.F.R. § 1100.19. There was no evidence in the record to the contrary (other than a letter to the Commission relating to one minor branch line). In now claiming otherwise, the Commission is not only attacking its own record but is also quarreling with its own order. Its August 9, 1974 order stated (JS 81a):

> "[T]he definitions of deferred maintenance and delayed capital improvements . . . reserves to the management of each railroad in the exercise of its proper and prudent managerial functions the determination of the extent to which these conditions exist in respect to their properties."

An agency cannot ignore its own orders. *Service* v. *Dulles*, 354 U.S. 363 (1957); *Accardi* v. *Shaughnessy*, 347 U.S. 260 (1954).

The Commission has advanced nothing to counter the array of facts establishing the arbitrary, capricious and unlawful nature of its conditions when applied to Chessie. They must be set aside for this reason alone, regardless of how the power issue is decided.

CONCLUSION

The Commission's basic position is that it may impose its will upon Chessie by withholding its power to suspend a rate increase on condition that Chessie accept Commission directives as to how the funds shall be spent. But Chessie is not required to acquiesce. Federal courts have the power to annul and enjoin actions of the Commission *"in whole or in part"* (28 U.S.C. § 1336(a)); they may enjoin illegal conditions attached to an otherwise lawful order. *United States* v. *Chicago, Milwaukee, St. Paul & Pacific R.R.*, 282 U.S. 311 (1931).

The judgment below should be affirmed.

Respectfully submitted,

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